HERTFORDSHIRE COUNTY COUNCIL

Agenda Item No:
11

AUDIT COMMITTEE
18 JULY 2018 AT 2.00PM

END-OF-YEAR REPORT ON THE TREASURY MANAGEMENT SERVICE AND PRUDENTIAL INDICATORS 2017/18

Report of the Chief Finance Officer

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Executive Member: Ralph Sangster, Executive Member, Resources and Performance

1. Purpose of Report

1.1. The CIPFA Prudential Code and CIPFA Code of Practice for Treasury Management in the Public Sector require the Council to set an annual Treasury Management Strategy (TMS) and assess performance indicators and the treasury function throughout the year.

1.2. This report fulfils the requirement to provide an End-of-Year report on performance against the prudential indicators which were specified in the Integrated Plan, Part D approved by the County Council on 21 February 2017.

1.3. The report provides a summary of treasury management performance and activity for the financial year ended 31 March 2018, and follows on from the Mid-Year report to Audit Committee as at 30 September 2017. Treasury management performance indicators and narrative are also reported to Resources, Property and the Economy Panel within the quarterly budget monitor.

2. Summary

2.1. The Council has been compliant with the Prudential and Treasury Management Indicators set out in the Integrated Plan.

2.2. The total interest earned on Treasury Investments was £1.830m, exceeding the budget of £1.434m.

2.3. The performance of the UK economy has exceeded forecast expectations during 2017-18, despite significant uncertainty around the outcome of the negotiations around withdrawal from EU membership, although there are signs that the economy may be slowing. This is analysed in further detail in section 6.

2.4. The Council has continued to operate a diverse investment portfolio. Pooled fund investments are held for the long-term to mitigate capital volatility and generate income. Daily liquidity needs are met using a variety of instant-access bank and Money Market instruments, along with short term lending to and from other local authorities.

2.5. An additional disbursement from the Administrators of the Icelandic investment with Kaupthing, Singer & Friedlander [KSF] was made in December 2017. No further funds have been received for the Icelandic investments with Heritable. The recovery to date from these particular investments stands at 85.50% and 98.00% respectively.

2.6. A breach of the TMS occurred during May 2017 as a result of an operational error. This was previously reported in the Mid-Year Treasury Management report, and Section 5 provides further details of the breach and procedural changes implemented as a result. There was no loss to the authority as a result of this error and actions to mitigate any future occurrence were taken immediately.

2.7. No new long-term borrowing has been taken and no long-term borrowing has been repaid in the year.

2.8. Short-term borrowing was used between April and July 2017 to cover cash flow requirements. No short-term loans were in place at 31 March 2018.

2.9. There were a number of regulatory developments during the year. The Markets in Financial Instruments Directive II (MiFID II) became effective in January 2018. For 2018/19 new Investment and MRP Guidance was issued by MHCLG, and CIPFA Published revised Prudential and Treasury Management codes. More information on the impacts and actions taken is provided in Section 12.

3. Recommendations

3.1. Members are invited to note the Treasury Management End-of-Year report.

4. Background

4.1. The Council operates its treasury management function in accordance with the CIPFA Prudential Code and the CIPFA Code of Practice for Treasury Management in the Public Sector. The Codes require the Council to set prudential indicators for its capital expenditure and treasury management activities prior to the start of each financial year.

4.2. The Codes also require that regular reports are provided reviewing performance and compliance at the end of each financial year and on a half-yearly basis. In addition to these reports, performance against the prudential indicators and treasury management activities are reported to Cabinet as part of the quarterly budget monitoring report.

5. Breach of Strategy (4 May 2017)

5.1. The breach arose as the methodology being used to record overnight changes in balance on the Barclays account on the Treasury Management System did not trigger a control warning when the exposure limit was breached. As a result a balance of £10.275m was held in the account overnight, breaching the limit of £10m in place for this counterparty. The balance was correctly reduced the following day.

5.2. Procedures for recording overnight balance changes have been revised so that an alert is correctly triggered if balances are recorded in excess of the limits set in the system. All treasury officers have been instructed in the revised data entry method to avoid breaching counterparty limits. No financial loss was incurred as a result of this breach.

6. Arlingclose Economic Review

6.1. The Council's Treasury management activities in this period were undertaken in an environment marked by uncertainty over the UK's future relationship with the EU, geopolitical tensions, and the influence of expectations around the potential for fiscal tightening in the US and EU.

6.2. Despite a decline in household, business and investor sentiment in the face of political uncertainty, UK economic growth remained resilient, and GDP growth was recorded throughout the year. This is reflective of strong international growth, in the US and Eurozone, generating increased trade.

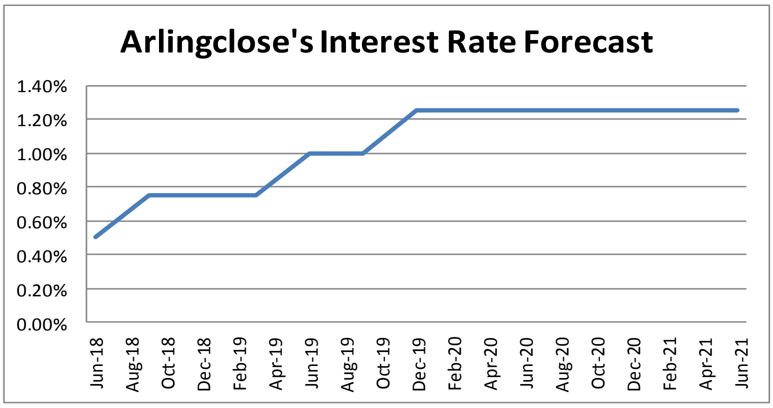
6.3. UK inflation has been above the Bank of England's 2% target throughout the year as a consequence of the significant reduction in the value of Sterling following the vote to leave the EU. Annual CPI inflation reached a peak of 3.1% in November 2017, but has since fallen more rapidly than expected to reach 2.4% by March 2018.

6.4. The labour market has also shown resilience, with the headline unemployment rate at 4.2% in February 2018. UK wage growth was lower than inflation for much of 2017/18, with positive real-terms being achieved in March 2018. This pressure on incomes was reflected in weaker consumer spending and a challenging operating environment for the retail sector affecting GDP growth.

6.5. Concern about the high level of inflation prompted the Monetary Policy Committee of the Bank of England to increase the official interest rate to 0.50% from 0.25% in November 2017. The Bank has indicated that a limited number of further rate increases are likely, but not certain. The action to increase rates will also give the Bank more flexibility to provide economic stimulus at a later date if required.

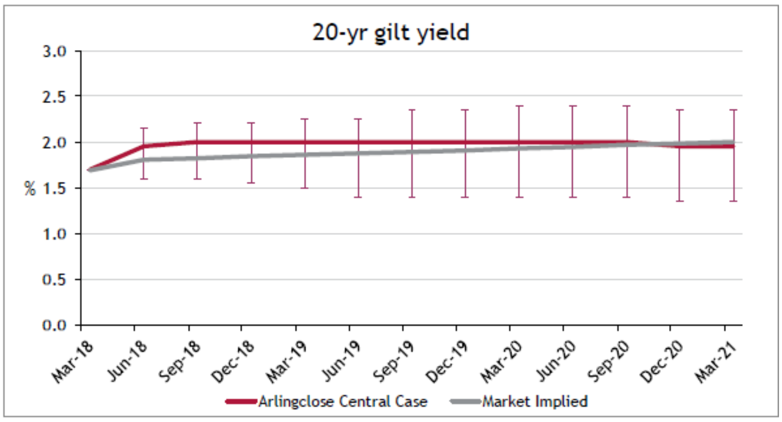
6.6. Graph 1 (overleaf) provides the Arlingclose (the Council's treasury adviser) interest rate forecast for the period March 2018 to June 2021. This indicates their view that the Bank of England is likely to sanction a limited number of interest rate increases over the forecast period.

Graph 1: Arlingclose Interest Rate Forecast for Base Rate



6.7. Graph 2 provides the Arlingclose forecast for 20-year gilt yields, compared to the market implied forecast. This supports the above view that rates are likely to remain low. It also demonstrates the range of uncertainty and outlook for possible changes to rates for new PWLB borrowing.

Graph 2: Arlingclose 20-Year Gilt Projection



7. Prudential and Treasury Management Indicators

7.1. The Prudential Code requires the Council to set and monitor a range of prudential indicators relating to borrowing. The objectives of the Prudential Code are to ensure, within a clear framework, that capital investment plans for local authorities are affordable, prudent and sustainable, and that treasury management decisions are taken in accordance with good professional practice.

7.2. The Council measures and manages its exposure to treasury management risks using a range of indicators related to interest rate exposure, refinancing risk and liquidity risk. In addition, treasury activity is measured against a range of performance indicators related to security, liquidity and yield.

7.3. Appendix A provides evidence of compliance with the prudential and treasury management indicators and reports on treasury activity performance indicators.

8. Treasury Management Strategy

8.1. In setting the 2017/18 TMS, the Council approved a Lending Policy that continued to enable flexibility in use of investment instruments whilst maintaining security and liquidity of investments. The 2017/18 Lending Policy was unchanged from the 2016/17 TMS.

8.2. The Lending Policy continued to reflect the on-going risks in the wider economy and banking institutions. The primary considerations when placing investments continues to be the security and liquidity of the Council's funds and only once both of these factors have been taken into account will the yield on investment be considered. Long term borrowing is only considered when it becomes necessary to avoid a prolonged short term overdraft position.

8.3. During the year to 31 March 2018, investments have been held in a range of instruments detailed in Table 1.

Table 1: Counterparties and Investment Instruments 2017/18

Counterparty	Investment Instruments
Local Authorities	Fixed Term
UK Banks / Building Society	Call / Notice Accounts
Overseas Banks with AA+ Sovereign Rating	Call Accounts, Fixed Bonds
AAA rated Money Market Funds	Call / Notice
Pooled Fund – Property	Notice
Pooled Fund – Bond	Notice
Pooled Fund – Equity	Notice
Pooled Fund – Multi-asset	Notice
Debt Management Office	Account Deposit Facility [DMADF]

8.4. Table 2 (overleaf) provides a summary of the value of investment instruments outstanding as at 30 September 2017 and 31 March 2018 and the percentage of investment instruments compared to the overall investment portfolio.

Table 2: Investment Balances
As at 31 March 2017 and 31 March 2018

Counterparties	Investment Instrument	31/03/2017		31/03/2018	
		£m	%	£m	%
Local Authorities	Fixed Term	5.00	4.9	23.00	16.3
UK Banks / Building Society	Call / Notice	16.65	16.2	9.97	7.0
Overseas Banks	Fixed Bond	3.02	2.9	0.00	0.0
CNAV Money Market Funds	Call	30.32	29.6	61.03	43.1
VNAV Money Market Funds	Notice	17.50	17.1	17.50	12.4
Pooled Fund – Property	Notice	10.00	9.8	10.00	7.1
Pooled Fund – Bond	Notice	10.00	9.8	10.00	7.1
Pooled Fund – Equity	Notice	6.00	5.9	6.00	4.2
Pooled Fund – Multi-asset	Notice	4.00	3.9	4.00	2.8
TOTAL		**102.49**	**100.0**	**141.50**	**100.0**

8.5. Table 2 reflects the diversified investment portfolio being operated by the council within the bounds of the TMS.

8.6. Table 3 shows the number and value of maturities and new investments in fixed term instruments during the year.

Table 3: Value of Maturities and New Investments
1 April 2017 – 31 March 2018

Instrument Type	Investment		Maturities	
	No.	£m	No.	£m
31 Day Notice Account	1	10.00	1	(10.00)
95 Day Notice Account	1	0	1	(10.00)
Fixed Deposit – Other Authority	16	100.00	13	(82.00)
Bond	0	0	1	(3.02)
DMADF	6	179.00	6	(179.00)
TOTAL	**7**	**289.00**	**6**	**(284.02)**

8.7. A total of £30m continues to be invested over the long term in a number of diversified pooled funds. At 31 March 2018, the net market value of the investment in these funds was approximately £30.69m. This represents an increase of approximately £120k on the valuation at 31 March 2017. The changes in market value are fluid depending on market conditions and are therefore not recognised as gains or losses in the financial statements.

8.8. Cash balances have increased by £39.01m between 31 March 2017 and 31 March 2018. The overall increase in cash balances was due to timing differences between receipts and payments, including £33m of Single Local Growth Fund funding awarded to the LEP and held within the Council's balances, but not fully spent during the year. Interest earned on LEP balances is apportioned to the LEP at year end.

8.9. Interest rates for investments have ranged between 0.27% and 0.85% for fixed durations of up to 364 days. Interest rates on variable investments were as high as 0.18% at the start of the year and are now as high as 0.53%. Rates have increased following the decision by the Bank of England MPC to increase base rate in November 2017.

8.10. Table 4 provides a summary of the treasury activity in the year to 31 March 2018.

Table 4: Treasury Activity - 1 April 2017 to 31 March 2018

Measure	2017/18	2016/17
Average size of portfolio (excluding Iceland investments)	£144.88m	£110.72m
Weighted average term (fixed term only)	64 days	79 days
Average rate earned	1.26%	1.58%
Interest earned	£1.830m	£1.749m

8.11. The overall rate of return peaked in the second quarter at 1.45%, compared to 1.35% in the first quarter. Returns declined during the second half of the year, with 1.22% recorded in the third quarter and 1.07% recorded in the final quarter. The average return for the year was 1.26%.

8.12. The variability in the overall rate of return reflects a number of factors, including changes in overall balances, and decisions about liquidity risk management which impacted the choice of instruments used:

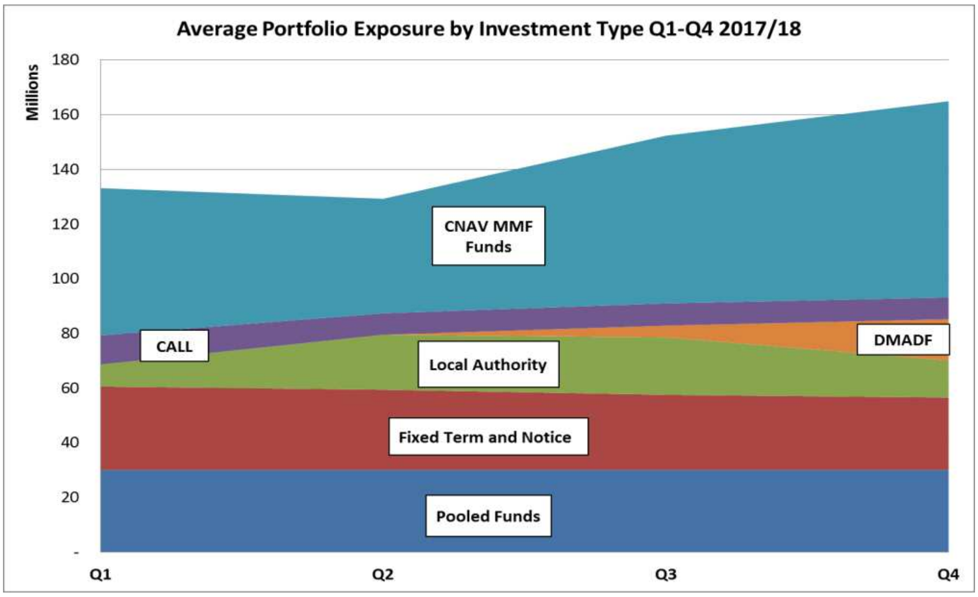
Increased Overall Balance

The increased overall balance increases the proportion of the portfolio exposed to lower short-term rates relative to the stable investment in higher-yielding strategic investments (the pooled funds). The following table (based on appendix A) reflects the inverse relationship between the overall rate of return and average investment balance

Measure	Q1	Q2	Q3	Q4
Average Balance	£133.47m	£129.02m	£152.38m	£164.97m
Interest Earned	£0.451m	£0.467m	£0.464m	£0.448m
Overall Rate of Return	1.35%	1.45%	1.22%	1.07%

Choice of Instruments

The chart overleaf shows the average exposure to different types of instruments in each quarter throughout the year. This reflects decisions on instrument choices made with reference the expected liquidity demands.



The chart demonstrates a marked increase in the use of liquidity instruments vs longer-term instruments, during the second half of the year. This approach was taken to ensure adequate liquidity was available to cover expected capital expenditure. The DMADF was used during periods of peak balances, in order to avoid excessive exposure to CNAV MMFs. DMADF pays low rates, but has the advantage that a deposit can be made for any duration of the depositor's choosing, improving the ability to match maturities to planned cash outflows. The result of this approach is an increased bias towards lower yielding investments.

Interest Rates

The approach taken to the use of liquidity instruments in the second half of the year restricted the Council's ability to take advantage of increasing market rates from November 2017. Money Market Funds hold a range of underlying assets, with a range of maturities. The yield of these assets is linked to market rates at the time of purchase, and the resale value of the asset varies in response to market rates. Following the increase in base rate the funds must hold the assets to maturity in order to avoid a loss on trading the assets. As assets mature, they are replaced by assets yielding at current market levels. The result of this process is that there is a lag between the change in base rate, and improved rates on MMF investments.

The table below indicates the average rate of return on this element of the portfolio from October 2017 to March 2018:

Measure	October	November	December	January	February	March
Base Rate	0.16%	0.26%	0.31%	0.34%	0.36%	0.38%
MMF Average	0.25%	0.50%	0.50%	0.50%	0.50%	0.50%

Fixed term interest rates for new investments with Local Authorities respond more quickly than funds, but the Council's liquidity forecast meant that only limited new investments could be made following the rate change.

8.13. The pooled fund investments continue to make a significant contribution to overall interest income. The return for the year on pooled fund investments was 4.67% per annum compared to 4.79% last year.

8.14. The rate of return for the year (1.26%) includes underlying returns of 0.37% for the investment portfolio excluding the pooled fund investments. The 0.37% rate compares to 0.46% achieved in 2016/17 and exceeds the 7-day LIBID benchmark of 0.21% by 0.16%.

8.15. The total interest earned on treasury investments during the year is £1.830m, which exceeded the budget by £0.396m. Whilst investment balances have increased, returns on highly liquid investments have recovered slowly following the base rate increase, damping the impact of high balances. The pooled funds have continued to perform strongly and returns exceed the 4% target level.

8.16. The pooled funds have experienced some variations in capital value during the year. This variability is expected as the nature of these types of investments in bond, equity and multi-asset funds means that income yield and fund values are influenced by market movements. It is important to recognise the long-term nature of these investments in mitigating this expected volatility.

As at the 31 March 2017 a small overall capital gain was reported, with a slightly higher overall gain reported as at 31 March 2018. Appendix A, Section 3 provides more details of how the Council intends to utilise and balance these instruments alongside its existing investments with regards to management of security, liquidity and yield.

8.17. With the exception of the breach described in Section 5, all treasury management activity undertaken during the period complied with the approved Treasury Management Strategy, the CIPFA Code of Practice for Treasury Management and the relevant legislative provisions.

9. Icelandic deposits

9.1. Of the original four Icelandic banks in which HCC had deposits, the outstanding Landsbanki claim was sold in 2013/14 resulting in a total recovery of 92%. The outstanding Glitnir claim was resolved in February 2015 resulting in a total recovery of 101% of the amounts originally deposited.

9.2. The recovery rate of 101% for Glitnir reflects exchange rate gains following the conversion of disbursements held in Escrow in Icelandic Krona into £ Sterling.

9.3. As of 31 March 2018 repayments for the investments in Heritable total 98.0p in the £. The Administrators, Ernst and Young (EY), are not forecasting any additional distribution to creditors. The claim cannot be closed as a reserve has been retained to cover administrator costs and expenses until outstanding legal matters are resolved.

9.4. A repayment of 0.90p in the £ was announced by the administrator (EY) for the investments in Kaupthing, Singer & Friedlander (KSF) and paid in May 2017. A further dividend of 0.35p in the £ was paid in December 2017.

EY estimates that the total return will be between 86.25p and 87.0p in the £. Recovery as at 31 March stood at 85.50p in the £.

9.5. Table 5 provides details of dividends received to 31 March 2018 together with current information about the anticipated value and percentage recovery for Icelandic investments.

Table 5: Icelandic bank deposits at 31 March 2018
ALL Claims

Bank	Original Deposit	Recovered at 31/03/2018	Total expected distribution		Claim Status
	£m	£m	£m	%	
Glitnir	7.00	7.05	7.05	100.71	Closed
Landsbanki	10.00	9.23	9.23	92.30	Closed
Heritable Bank	7.00	6.88	6.88	98.00	Open
KSF	4.00	3.51	3.55	86.63	Open
TOTAL	**28.0**	**26.67**	**26.71**	**95.39**	

10. Borrowing

Long Term Borrowing

10.1. Table 6 (overleaf) shows total long term borrowing outstanding at 31 March 2018, the future maturity profile of borrowing and an analysis of sources of borrowing shown as a percentage of the total.

Table 6: Borrowing Maturity Profile as at 31 March 2018

	Total	Sources of Borrowing					
		PWLB [1]		LOBO [2]		Commercial [3]	
	£m	£m	%	£m	%	£m	%
Borrowing at 31 March 2018	258.78	103.28	39.9	49.40	19.1	106.10	41.0
Maturing in 2018/19	0.00	0.00	0.0	0.00	0.0	0.00	0.0
Maturing in 2019/20	0.25	0.25	0.0	0.00	0.0	0.00	0.0
Maturing later	258.53	103.03	39.9	49.40	19.1	106.10	41.0
Average interest rate	**4.61%**		**5.36%**		**4.37%**		**4.43%**

[1] Borrowing sourced from the government's Public Works Loans Board
[2 & 3] Borrowing sourced from commercial banks

10.2. At 30 September there was a total of £258.78m long term borrowing outstanding. £103.28m (40%) was sourced from the government's Public Works Loan Board and £155.50 (60%) was sourced from commercial banks.

10.3. No new Long Term Borrowing has been arranged since March 2009, and consequently interest rates for the Council's long-term loans reflect historically higher rates than are currently available. The average rate of interest for total borrowing was 4.61%, the average rate for PWLB borrowing was 5.36% and the average rate for borrowing from commercial banks was 4.41%.

10.4. The Commercial Loan portfolio of £155.5m at the start of the year included £49.40m of Lender Option Borrower Option loans, which is a product which confers on the lender the right to increase the interest rate. In the event that this happens the borrower has the right to repay the loan without penalty.

10.5. The long term borrowing portfolio is kept under review in consultation with the Council's treasury advisor Arlingclose to identify opportunities to reduce borrowing costs by restructuring existing loans.

10.6. The difference between planned capital expenditure and capital funding (from revenue or capital receipts and specific capital grants) is known as the Capital Financing Requirement (CFR), and is met via borrowing. Borrowing can be funded from externally sourced loans, for example from the Public Works Loans Board, or internally from the council's own resources.

10.7. Because the cost of long term borrowing remains significantly higher than the return on short-term investments, the Council has made prudent use of its resources to fund an element of its borrowing requirement from surplus cash balances held in respect of its reserves. This has allowed the Council to maintain a lower level of external borrowing, which has in turn minimised the pressure on revenue budgets from interest payments.

11. Short Term Borrowing

11.1. Short term borrowing was required during the first half of the year, due to forecast differences in timing between receipts and their associated payments. Maximum short term borrowing in place at any one time during the year was £30m.

11.2. This was sourced through direct contact or external brokers, from other local authorities, at rates varying from 0.25% to 0.47% (including brokerage fees of between 0.03% - 0.10%) for durations of 7 to 139 days.

11.3. All short-term borrowing was repaid during the year.

12. Regulatory Changes

CIPFA Code Revisions

12.1. CIPFA published revised editions of the Treasury Management and Prudential Codes in December 2017. The required changes from the 2011 Code will be incorporated into the 2019/20 Treasury Management Strategy Statement (TMSS), or any revisions to the strategy made during 2018/19.

12.2. The 2017 Prudential Code introduces the requirement for a Capital Strategy which provides a high-level overview of the long-term context of capital expenditure and investment decisions and their associated risks and rewards along with an overview of how risk is managed for future financial sustainability. Where this strategy is produced and approved by full Council, the determination of the Treasury Management Strategy can be delegated to a committee. The Code also expands on the process and governance issues of capital expenditure and investment decisions.

12.3. Due to the late publication of the Code the Council has not prepared a Capital Strategy under the 2018 Prudential Code. It is permitted to defer this, and the Council will produce a Capital Strategy from 2019/20.

12.4. In the 2018 Treasury Management Code the definition of 'investments' has been widened to include financial assets as well as non-financial assets held primarily for financial returns such as investment property. These, along with other investments made for non-treasury management purposes such as loans supporting service outcomes and investments in subsidiaries, must be discussed in the Capital Strategy or Investment Strategy. Additional risks of such investments are to be set out clearly and the impact on financial sustainability is to be identified and reported.

12.5. Changes to Treasury Management and Prudential Indicators will be implemented during the year, and publication of detailed guidance to support this is expected during the summer of 2018.

MHCLG Investment Guidance and Minimum Revenue Provision

12.6. In February 2018 the MHCLG (Ministry of Housing, Communities and Local Government) published revised Guidance on Local Government and Investments and Statutory Guidance on Minimum Revenue Provision (MRP).

12.7. Changes to the Investment Guidance include a wider definition of investments to include non-financial assets held primarily for generating income return and a new category called "loans" (e.g. temporary transfer of cash to a third party, joint venture, subsidiary or associate). The Guidance introduces the concept of proportionality, proposes additional disclosure for borrowing solely to invest and also specifies additional indicators. Investment strategies must detail the extent to which service delivery objectives are reliant on investment income and a contingency plan should yields on investments fall.

12.8. The definition of prudent MRP has been changed to "put aside revenue over time to cover the CFR"; it cannot be a negative charge and can only be zero if the CFR is nil or negative. Guidance on asset lives has been updated, applying to any calculation using asset lives. Any change in MRP policy cannot create an overpayment; the new policy must be applied to the outstanding CFR going forward only.

12.9. The Council must ‘have regard’ to the MHCLG Guidance, and it will be incorporated in future revisions or new versions of the Treasury Management Strategy.

MiFID II

12.10. Part of a package of European legislation to improve regulation of the financial sector, the second Markets in Financial Instruments Directive (MiFID II) came into effect on 3rd January 2018.

12.11. Under earlier legislation Local Authorities were considered to be de facto ‘professional’ clients, with open access to financial markets. This position is reversed under MiFID II, and Local Authorities are now considered by default to be retail clients.

12.12. Clients with retail status are unable to access some of the instruments and facilities permitted within the Council’s TMSS

12.13. The legislation introduces quantitative and qualitative criteria which must be met by Local Authorities who wish to “opt up” to ‘elective professional client’ status.

12.14. The quantitative criterion is for the Council to have an investment balance of at least £10 million. The qualitative criterion is for the person(s) authorised to make investment decisions on behalf of the authority to have at least a year’s relevant professional experience.

12.15. It is the responsibility of each regulated financial services firm to whom this directive applies to assess their customers’ eligibility for elective professional status, including that the person(s) duly authorised have the expertise, experience and knowledge to make investment decisions and understand the risks involved

12.16. The Authority meets the conditions to opt up to professional status and has done so in order to retain the professional status held prior to January 2018. The Authority will continue to have access to products including money market funds, pooled funds, treasury bills, bonds, shares and to financial advice.

13. Hertfordshire Police and Crime Commissioner – Treasury Management

13.1. The Police and Crime Commissioner (PCC) contracts with Hertfordshire County Council to deliver its Treasury Management services.

13.2. A separate treasury management strategy is maintained for the PCC. Data concerning the Police’s cashflow is provided to the Council’s treasury officers and any surplus cashflow is invested in accordance with the investment criteria outlined in the PCC’s Treasury Management Strategy. The Police’s cashflow and investment portfolio is maintained separately from the Council’s funds.

13.3. The reporting arrangements for the PCC are similar to the Council's. An annual treasury management strategy is prepared before the start of each financial year, with mid-year and end-year reports subsequently delivered on treasury management activities and delivery of the strategy. Quarterly reports are also provided according to the schedule of meeting dates provided by the PCC.

APPENDIX A: PRUDENTIAL INDICATORS 2017/18

1. Capital financing Indicators

	Indicator	Description	Integrated Plan Ref.	2017/18 IP	2017/18 Q1	2017/18 Q2	2017/18 Q3	2017/18 Q4
	Indicators 1 to 3 demonstrate the affordability and sustainability of the capital programme. The projections for financial years 2017/18 to 2018/19 are set out in the Integrated Plan at the reference shown in the table below.							
1	**Capital Expenditure** Monitors capital expenditure for 2017/18 against the projections set out in the Integrated Plan		2.4 Table 1	£219.29m	£192.40m	£174.70m	£164.74m	£147.23m
2	**Capital Financing Requirement (CFR)** Monitors the Council's underlying need to borrow for capital purposes for 2017/18 against the projections set out in the Integrated Plan		2.10 Table 3	£580.44m	£577.80m	£564.81m	£564.44m	£548.52m
3	**Ratio of financing costs to net revenue stream** Monitors the percentage of revenue budget set aside to service capital financing costs (borrowing costs net of lending income) for 2017/18 against projections set out in the Integrated Plan.		2.11 Table 4	1.47%	1.37%	1.35%	1.32%	1.31%

	Indicator	Description	Integrated Plan Ref.	2017/18 IP	2017/18 Q1	2017/18 Q2	2017/18 Q3	2017/18 Q4
	Treasury Position: **The Treasury Management Prudential Indicators are set to contain lending and borrowing activities within approved limits. The indicators are set at a level that will provide enough flexibility for effective treasury management whilst managing the risk of a negative impact on the Council's overall financial position in the event of adverse movements in interest rates or borrowing decisions. The indicators are also used to demonstrate that Net Borrowing does not exceed the Capital Financing Requirement. The projections for financial years 2018/19 to 2020/21 are set out in the Integrated Plan.**							
4A	**Net Borrowing**		NA	NA	£151.08m	£137.89m	£126.43m	£117.29m
	Monitors actual borrowing less actual lending							
4B	**Net Borrowing Less than CFR**		NA	NA	✓	✓	✓	✓
	Comparison of net borrowing to CFR							
	Borrowing: Indicators 5 and 6 control the overall level of borrowing. The limits for 2017/18 to 2019/20 are set out in the Integrated Plan. The Authorised Limit is the maximum amount that may beyond which borrowing is prohibited without Member Approval. The Operational Boundary is an estimate for the external debt for the financing year – this is not a limit but an indicator to ensure the authorised limit is not breached.							
	Total Borrowing in Place at Quarter End		Borrowing in £ at Q End		£288.8m	£258.8m	£258.8m	£258.8m
	Maximum Borrowing Exposure in Quarter		Quarter Maximum in £		£298.8m	£288.8m	£258.8m	£258.8m
5	**Authorised Limit**		6.5 Table 11	Limit	£495m	£495m	£495m	£495m
	Compliance Indicator			Complied?	✓	✓	✓	✓
6	**Operational Boundary**			Indicator	£465m	£465m	£465m	£465m
	Compliance indicator			Complied?	✓	✓	✓	✓

2. Treasury Management Indicators

	Indicator	Description	Integrated Plan Ref.	2017/18 Budget	2017/18 Q1	2017/18 Q2	2017/18 Q3	2017/18 Q4
	Interest Rate Exposure: **Indicators 7 and 8 limit the Council's exposure to both fixed and variable interest rate movements.** **The limits for 2017/18 to 2017/18 are set out in the Integrated Plan.**							
7	**Upper limit on fixed interest rates *(against maximum position)***	Monitors the limits set for 2017/18 for the volume and value of the (lending) /borrowing portfolios that may be committed for fixed interest rate investments or borrowing	6.7 Table 12	£395.00m (LIMIT)	£258.78m	£258.78m	£258.78m	£258.78m
8	**Upper limits on variable interest rates *(against maximum position)***	Monitors the net limits set for 2017/18 for the volume and value of the (lending) /borrowing portfolios that may be committed for variable interest rate investments or borrowing	6.7 Table 12	£118.50m (LIMIT)	(£107.70m)	(£120.89m)	(£132.34m)	(£141.49m)
	Maturity structure of fixed rate borrowing (against maximum position): **Indicator 9 limits the Council's exposure to large fixed rate sums falling due for refinancing in the same period.** **The indicators are set relatively high to give the council enough flexibility to respond to opportunities to repay or reschedule debt during the financial year, while remaining within the parameters set by the indicators.**							
9A	Under 12 months		6.8 Table 13	50%	0.00%	0.00%	0.00%	0.00%
9B	12 months to 2 years		6.8 Table 13	50%	0.00%	0.10%	0.10%	0.10%
9C	2 years to 5 years		6.8 Table 13	60%	1.22%	2.09%	2.09%	2.09%
9D	5 years to 10 years		6.8 Table 13	80%	3.28%	5.60%	5.60%	5.60%

	Indicator	Description	Integrated Plan Ref.	2017/18 Budget	2017/18 Q1	2017/18 Q2	2017/18 Q3	2017/18 Q4
9E	10 years to 20 years		6.8 Table 13	85%	7.92%	7.10%	7.10%	7.10%
9F	20 years to 30 years		6.8 Table 13	90%	12.34%	9.88%	9.88%	9.88%
9G	30 years and above		6.8 Table 13	100%	75.24%	75.24%	75.24%	75.24%
	Investments greater than 364 days (against maximum limit): **Indicator 10 measures the Council's exposure to investing for periods greater than one year.** **This indicator is required to ensure that the Council is aware of the cashflow implications for long term investments.** **This includes deposits at risk in Icelandic Banks.**							
10	Investments greater than 364 days (Maximum Limit)*		6.9 Table 14	£50m	£30.63m	£30.63m	£30.61m	£30.61m

*Includes Pooled Fund investments, which can be withdrawn in less than one year but the intention is to hold for the long-term to minimise the risk of capital value volatility, as agreed at Full Council on the 25th November 2014.

3. Treasury Management Performance and Activity Measures

Indicator	Description	Integrated Plan Ref.	2017/18 Q1	2017/18 Q2	2017/18 Q3	2017/18 Q4
The CIPFA Treasury Management Code of Practice requires the Council to set performance indicators to assess the treasury function. Group A measures performance for "Security, Liquidity and Yield" and Group B measures the performance of "Operational Activities"						
GROUP A: Security, Liquidity and Yield						
Average Investment Portfolio		7.3 Table 16	£133.47m	£129.02m	£152.38m	£164.97m
Monitors the average amount HCC has had invested in third parties.						
Average borrowing portfolio		6.3 Table 10	£258.78m	£258.78m	£258.78m	£258.78m
Monitors the average amount HCC has as long term borrowing during the quarter						
Security Indicator: Average Credit Rating of Investments held		Section 6.10	4.46	4.72	4.44	3.96
Measured on a 1 to 10 scale, where 1 is a very good Credit Rating, i.e., government guaranteed						
Liquidity Indicator: Weighted Average Maturity of investments held		Section 6.10	23 days	14 days	9 days	14 days
Measures the liquidity/accessibility of investments in average days						
Yield Indicator: Interest Earned*		7.3 Table 16	1.35% £0.451m	1.45% £0.467m	1.22% £0.464m	1.07% £0.448m
Monitors the interest earned on HCC investments. Shown as the actual amount (in quarter) and equivalent annual percentage of amount invested						
Yield Indicator: Interest Paid		7.2 Table 15	4.35% £3.13m	4.74% £3.10m	4.79% £3.12m	4.79% £3.06m
Monitors the interest earned on HCC investments. Shown as the actual amount (in quarter) and equivalent annual percentage of amount invested						

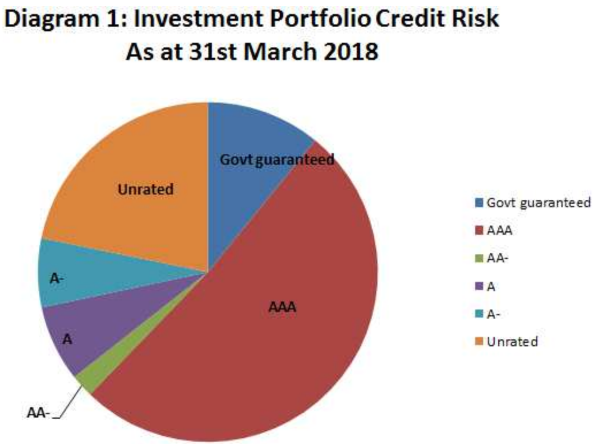
*includes Pooled Fund investment returns some of which are estimated, see Yield section below for further information for rate excluding Pooled Funds

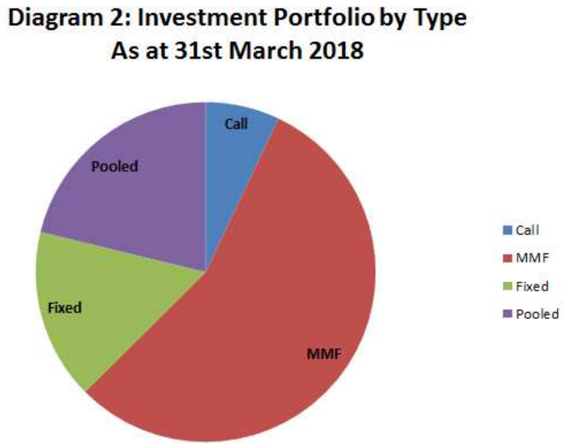
Security, Liquidity and Yield

Security - Exposure to Risk

The Treasury Management Strategy was approved on 21st February 2017 as Part D of the Integrated Plan. This maintained the range of investment types approved for use in 2016/17. The approved instruments were last changed in 2014/15 to enable greater diversification of the investment portfolio; these changes introduced greater flexibility in use of investment instruments whilst continuing to maintain security and liquidity of investments.

The following diagrams illustrate the credit rating breakdown of all investment instruments by credit rating grade and investment type for the Council's investment portfolio as at 31st March





Investment Portfolio and Activity

The greater proportion of the investment portfolio is held in highly liquid money market funds and call accounts. This reflects the need to ensure adequate liquidity in the management of cash balances to meet daily cashflow requirements.

Investments in pooled funds consist of the CCLA Property Fund, two bond funds, two multi-asset funds and one equity fund.

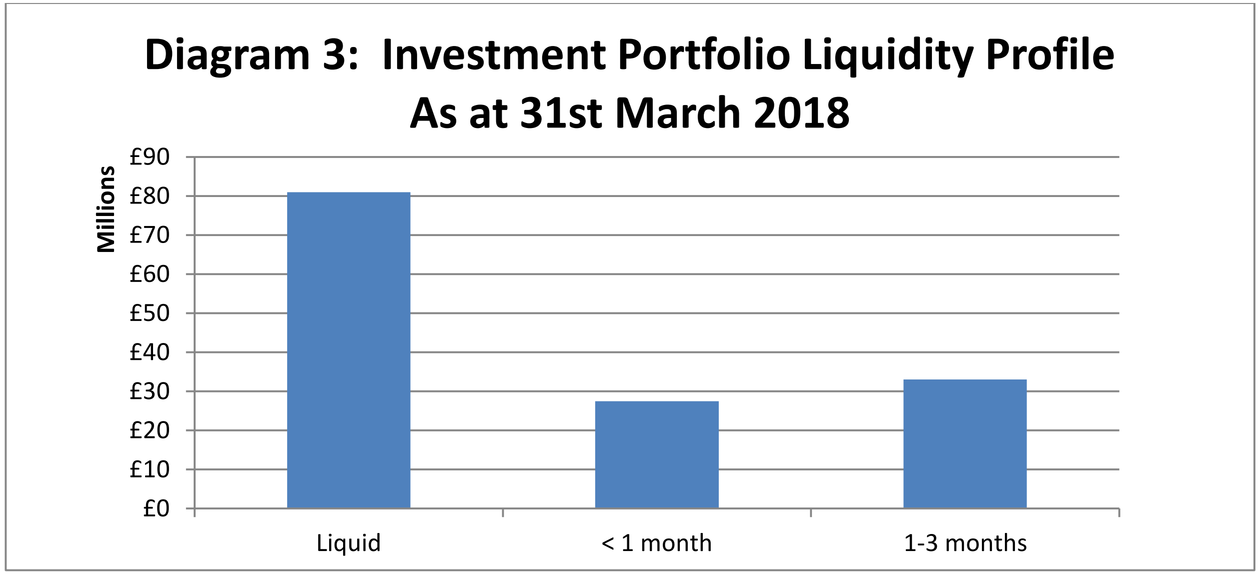
12 new fixed deposits were made, and 11 matured, during the period. 5 were with the Debt Management Office and the remainder with Local Authorities.

Liquidity

Investment balances forecast to reduce during the second half of 2017/18 in fact increased and as a result of uncertainty about cashflows for capital expenditure a larger proportion of the portfolio was held in short term investments – with the DMADF during periods of high cash balances. As certainty about cash balances improved some new fixed-term loans to other local authorities were made towards the end of the quarter, reducing overall liquidity.

Diagram 3 (overleaf) provides a graph showing the liquidity of the Council's investments portfolio as at 31st March 2018.

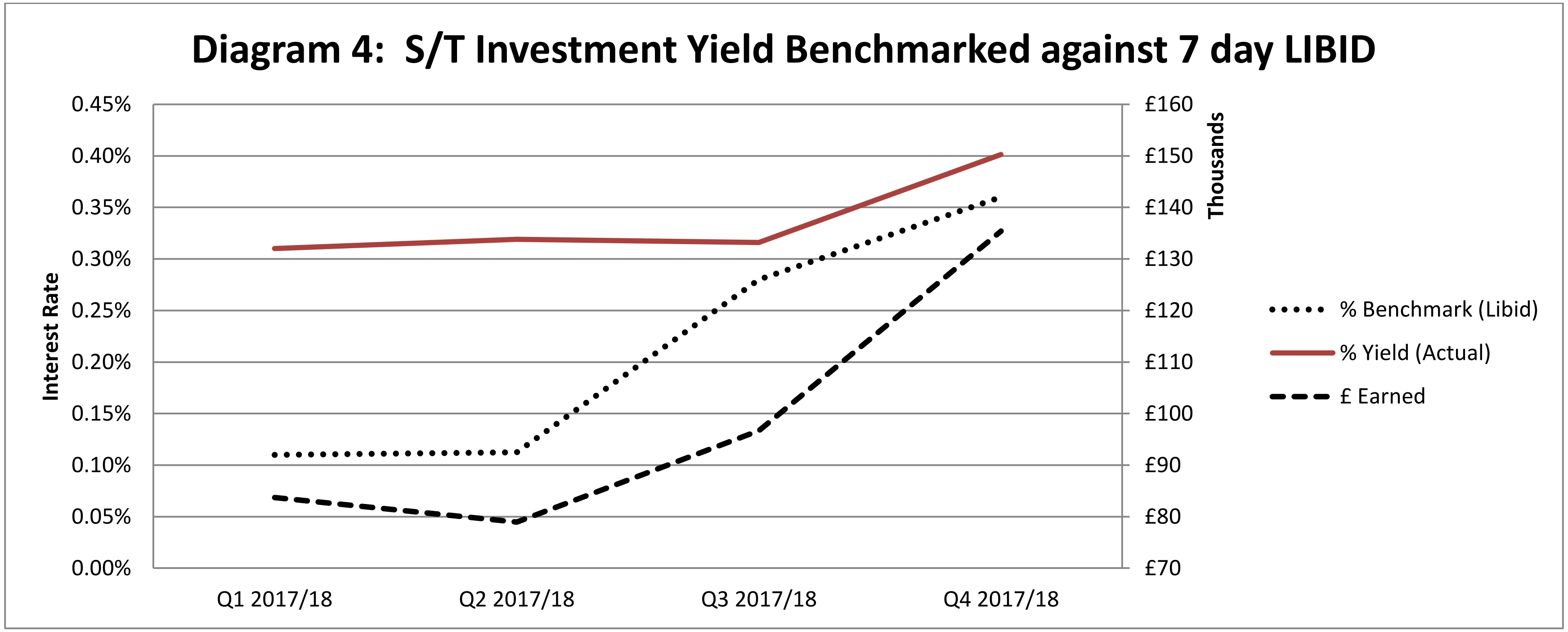
The potential capital volatility of the pooled fund investments means that they are intended to be held for 3-5 years, but in the graph below these investments are shown on the basis of their accessibility. These funds are all classified as "liquid", except the Property Fund which accessible on 30 days' notice.



Yield: Short-Term Investments

The benchmark used for assessing the performance of return on short-term lending is the 7-Day London Interbank Bid Rate (LIBID). Diagram 4 shows yield (solid line) against the benchmark (dotted line) for the last four quarters on the left-hand axis, and the actual cash earned (dashed line, right-hand axis).

LIBID remained constant at 0.11% during the first half of the year, remaining stable despite significant uncertainty in financial markets, and increased to 0.36% by the end of the year, following Bank of England Base Rate rise. The average return excluding pooled fund interest was 0.37%, which compares positively with LIBID average of 0.21%. Overall rate of return fell during the second half of the year; as balances increased a greater proportion of the portfolio was held for shorter durations at low rates.



Yield: Pooled Funds

The performance of the Council's strategic investments is benchmarked against the target yield level of 4.00%, which forms the basis of the income budget. Diagram 5 shows shows yield (solid line) against budget (dotted line) for the last four quarters on the left-hand axis, and the actual cash earned (dashed line, right-hand axis).

The Pooled funds have consistently achieved returns exceeding expectations, and the average % yield during 2017/18 is equivalent to 4.67% per annum.

Pooled fund returns reduced in the final quarter of 2017/18. All funds have suffered some capital losses due to a market correction in the fourth quarter where market expectations about inflation and interest rates increased, prompting a fall in bond and equity prices as investors sought improved returns.

The impact of this reduction will have prompted the bond fund managers to reduce the average maturity of the assets in the fund, resulting in reduced coupon income for the fund and may have caused losses to be realised on bond trading. Both of these factors will reduce the income available for disbursement to investors in the fund. The impact of the market correction is expected to be a one-off effect.